more than the minimum necessary to hand it off to another carrier, when it doesn't incur any different liability? More generally, CLECs (unlike connecting LECs) do not have networks in place already. They will design and build their networks in response to regulatory incentives. The perverse incentives of bill-and-keep will produce perverse results.

Bill-and-keep imposes a disproportionate burden on carriers that build an extensive network infrastructure. If one carrier has a more extensive local network than another carrier, then it performs more of the work involved in completing calls, going in both directions, between the two networks — even if the traffic flow in each direction is equal. A simple example illustrates this point. Suppose that a competing carrier has only one switch and connects to only one of the incumbent's (tandem) switches. Then it would do less of the work for each of the calls between its network and the area served by the incumbent's other switches. The following table describes the costs incurred by each network. In each case, the incumbent provider clearly incurs more costs, even when the number of calls in each direction is the same.[14]

Call Direction	Incumbent's Costs	Competitor's Costs
Incumbent to competitor	2 instances of switching; 2 instances of transport	1 instance of switching
Competitor to incumbent	2 instances of switching; 1 instance of transport	1 instance of switching; 1 instance of transport

Bill-and-keep also imposes a disproportionate burden on a carrier if traffic volumes between the carriers are unequal. The carrier terminating more calls bears a heavier burden than the carrier receiving fewer calls. Furthermore, bill-and-keep provides strong incentives for CLECs to target customers who make many more calls than they receive. Thus, unbalanced usage may be an inevitable consequence of bill-and-keep.

[14] It is assumed in the table that the originating carrier is responsible for delivering the call to an exchange office of the terminating carrier.

Bill-and-keep is particularly inappropriate for LEC-CMRS interconnection.[15] There are two principal reasons:

1. CMRS traffic is highly unbalanced. In this respect, it is almost a worst case for applying bill-and-keep.

2. Cellular interconnection charges provide substantial revenues toward funding LEC intrastate operations. Federal imposition of bill-and-keep would be analogous to an unfunded mandate. The FCC would achieve its (dubious) policy goals. State commissions would be left to figure out how to pay the cost. They would have to choose between a substantial reduction in LEC revenues and/or an increase in intrastate rates. The former harms consumers directly; the latter reduces the LEC's ability and incentive to invest in the network.

The case against bill-and-keep for CMRS providers is made in much greater detail in a study we prepared for the United States Telephone Association that was filed in the LEC-CMRS interconnection proceeding.[16]

F. Alternatives to Bill-and-Keep

Alternatives to bill-and-keep include usage charges (per-call and/or per-minute) and facilities-based charges. Both these approaches have merits and demerits. Negotiated agreements may contain elements of each and may vary from area to area. In general, usage charges for interconnection provide less incentive for disguising switched access. In addition, some level of usage charges is probably necessary to limit arbitrage possibilities where the incumbent has implemented local measured service.

Facilities-based charges avoid the need to meter usage. Thus, they may be less costly to implement in areas that have flat-rate local service. They may also be less susceptible to arbitrage in such areas. In addition, entrants would probably have lower marginal costs of usage with facilities-

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[15] One positive aspect of the FCC's proposal for LEC-CMRS interconnection is that is allows interconnection prices to be disaggregated into switching and transmission components. This is a good idea because it provides incentives for CMRS providers to expand their networks geographically.

[16] Rohlfs, Shooshan and Monson, *Bill-and-Keep: A Bad Solution to a Non-Problem, op. cit.*

based charges than with per-minute or per-call charges. They would therefore be more inclined to offer flat-rate plans and better able to compete with incumbents' flat-rate plans.

On the other hand, facilities-based charging may provide incentives for entrants to overuse facilities and degrade service in order to save on interconnection charges. The experience of ENFIA A is pertinent in this regard. Under ENFIA A, the interconnection charges for long-distance carriers were facilities-based. The consequence was, indeed, overuse of interconnection facilities and degradation of service. Usage of interconnection facilities far exceeded the expected levels.

Usage-based charging is relatively more favorable to smaller competitors; facilities-based charging is relatively more favorable to larger competitors. Different arrangements may therefore be suitable for different competitors. One size does not fit all.

G. State Regulation

The Act provides safeguards to ensure that negotiated agreements serve the public interest. Interconnection agreements are subject to review by state commissions. State commissions also have a role in resolving disputes that arise in negotiations. We believe that the FCC should allow this safeguard to operate, as envisioned in the Act. If negotiations break down, state commissions can deal with issues on a case-by-case basis, taking local conditions into account — including the structure of the LECs' intrastate rates. State commissions can evaluate these issues on their merits. They can determine whether a particular interconnection plan does, indeed, steer a middle course between Scylla and Charybdis; *i.e.*, whether it allows wide scope for efficient competition but avoids a regulatory giveaway.[17]

This role for state commissions should ideally extend beyond merely determining whether an agreement conforms to general federal guidelines. The best that such guidelines could do would be

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[17] Haring and Levitz describe a variety of reasons why decentralized decisionmaking is often preferable to centralized decisionmaking, particularly in the absence of real (as against pecuniary) external effects. They note that the same types of reasons that suggest that state decisionmaking will produce better results than federal decisionmaking also suggest that even more decentralized decisionmaking at the local level or ultimately as a result of bargaining in the marketplace may produce even better results. *See* J. Haring and K. Levitz, "The Law and Economics of Federalism in Telecommunications," *Federal Communications Law Journal*, Vol. 41, July 1989, No. 3, pp. 261-330.

to "get it right" only for the average circumstance, thereby getting it wrong in every other instance.[18] Experience also suggests that these issues are extremely difficult to get right the first time they are decided. Local competition cannot be implemented with one wave of a magic federal wand, but rather will be an evolving process that requires adapting to changing circumstances. If negotiations break down, state commissions can handle the case-by-case decisions that will be needed far more ably than can the FCC. This is recognized in the Act, where the states' roles are very clearly defined. One size does not fit all, and the country will benefit greatly from allowing each state the flexibility to define the arrangements best suited for its local conditions.[19]

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[18] Haring and Levitz (*op. cit.*, pp. 277-278) pose "the fundamental problem of a federal system of government" in the form of a question:

> [H]ow can the preference for decentralized decisionmaking be reconciled with the adverse consequences flowing from policies that ignore the important economic interdependencies linking those within and those beyond the boundaries of the decisionmakers' jurisdiction?"

Their recommended means of reconciliation is an "extrajurisdictional effects" test for assigning decisionmaking authority. On this view, the federal government should

> . . . not intrude on state policymaking prerogatives unless out-of-state interests were at risk. States would retain the authority to adopt any kind of intrastate telecommunications regulations, so long as no external effects were created (*op. cit.*, pp. 324-325).

[19] The FCC notes that some states have not yet begun to establish implementing rules for local competition. We have two responses to that observation. First, the Act establishes a process that must begin in all states. If a state fails to participate, it risks losing its jurisdiction to the FCC. Second, many states have begun already. For instance, the most-populous states have begun defining local competition rules for areas where a majority of Americans reside.

III. Unbundling

The Act [Section 251(c)(3) requires incumbent LECs to provide,

> . . . to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory.

Section 252(d)(1) requires that the prices a state commission sets for unbundled network elements shall be just and reasonable and

> '(A) shall be —
>
> '(i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and
>
> '(ii) nondiscriminatory, and
>
> '(B) may include a reasonable profit.

In this section, we consider steps that the FCC should (and should not) take in order for these provisions to be implemented in an economically-efficient manner.

A. Costs of Unbundling

The first point to note in any analysis of unbundling is that unbundling may be costly. That is, the LEC may incur less cost providing the bundle than providing all the elements separately. Consider the following examples:

1. When all loop transmission and local switching is integrated (*i.e.*, not unbundled), the LEC can deploy loop analog-to-digital conversion and multiplexing functionalities anywhere in the path from subscriber to switch, as economies dictate. As both the density and nature of traffic and the market price of equipment vary, analog-to-digital conversion may, over months and years, be moved from inside the central-office switch out to a channel bank located within the central office, or out even further into the field.

Unbundling affects this arrangement in several ways. First, connection points must be introduced into the network. This is done either by the insertion of additional switching and multiplexing equipment or by diverting capacity from existing equipment. Either option increases costs in the long run and reduces the LEC's flexibility.

2. Functions must be provided to maintain these access points and administer the constant churn in interfirm connections as providers enter and exit the market and modify the services they offer, and as customers switch back and forth between providers. These functions include the development, deployment and maintenance of operations support systems. All these activities are costly.

The incremental costs of unbundling (over and above the costs of the bundle itself) are caused by those who demand unbundled elements; those costs would not be incurred if the unbundled elements were not demanded. It therefore seems appropriate for the demanders of unbundled elements to pay the incremental cost of unbundling.[20] It also follows that the sum of the prices of unbundled elements may exceed the price of the bundle.

In general, requiring users to pay the costs that they cause promotes economic efficiency. If users of unbundled elements bear the incremental cost of unbundling, they will demand unbundled elements if and only if the resultant cost savings exceed the costs that the LEC incurs. Put another way, unbundled elements will be demanded if and only if their provision improves economic efficiency.

Demanders of unbundled services could cause massive economic waste if they are not required to pay the incremental cost of unbundling. They could demand unbundled elements at thousands of different points within the network, without regard to the LECs' costs. Under these circumstances, the benefits of unbundling might be only a tiny fraction of the incremental costs.

B. Contribution

The goal of unbundling is to allow competitors to provide service elements that they can provide more efficiently than the incumbent. (The efficiency may take the form of lower cost, higher

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[20] The prices of unbundled elements should not be discounted in order to nurture inefficient "infant" competitors. Infant industry protection has serious drawbacks, in any event. Furthermore, providing the protection in this particular way creates incentives for entrants to impose unnecessary costs on the network (economic disintegration).

quality, and/or additional service features that the LEC does not offer.) The pricing of unbundled elements should promote this goal.

For economic efficiency, the price of each unbundled element should cover at least its incremental cost. We have previously observed that unbundled prices should also include the incremental cost of unbundling. In addition, the price of the LEC bundle should normally include a contribution in addition to incremental cost. Part of the contribution can be construed as a "cost," as specified in Section 252(d)(1) of the Act. In addition, part of the contribution can be construed as "reasonable profit."

Notwithstanding the FCC's mischaracterization of the optimality of incremental cost pricing in its Notice, pricing unbundled elements at incremental cost with no contribution element is wholly indefensible from an economic standpoint. Such pricing allows end users to use LEC services indirectly (via a competitor) but make no contribution to the LEC's common and overhead (C&O) costs.[21] That outcome is patently unfair and does not allow a reasonable profit as required by the Act. It also invites inefficient entry. The entrant may bring nothing to the market other than an arbitrage mechanism that allows some end users to evade paying their share of LEC C&O costs.

Some services — especially access and toll services — have very high markups over incremental cost. At the same time, many local services have much smaller markups. Indeed, local usage is often priced at zero (flat-rate local service), implying a negative markup over incremental cost. Under this structure, large access and toll users pay the lion's share of the LEC's C&O costs. Much of these payments are support payments that cover the costs of telecommunications services consumed by other people. The need for support payments derives from the inefficient rate structure discussed above. Implicit subsidies have no place in a competitive telecommunications market. To improve economic efficiency and facilitate efficient competition, regulators must eliminate the support payments and rationalize support schemes as rapidly as possible. In the meantime, the pricing of unbundled elements need to take existing implicit subsidies into account. Under the existing price structure, certain classes of users are expected to provide the subsidies. That price structure will rapidly collapse if those end users can substantially reduce the subsidies they pay by (indirectly) purchasing unbundled elements.

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[21] If *service* incremental costs are inadequately defined so that total service costs are not recovered, this problem is exascerbated.

C. FCC Role

At least initially, we do not believe that the FCC should go beyond what is set out in the Act in establishing guidelines for unbundled network elements. The standard for unbundling in the Act is technical feasibility. Many things are technically feasible — at some cost. The key issue in most cases is whether the benefits of a particular element to a particular competitor are worth the cost. The FCC's information in this regard is very imperfect. The FCC can never know for sure whether the benefits to particular competitors exceed the costs. That answer may vary in unexpected ways across geographic locations. Under these circumstances, the FCC should proceed carefully to establish a framework in which the process contemplated by the Act (*viz.*, negotiation and arbitration) can produce results.

Congress has provided some guidance to the Commission as to the elements of such a framework in Sec. 271(c)(2)(B) which contains the so-called "competitive checklist." Bell Operating Companies which seek to provide interLATA services must demonstrate that they have made available to competitors' unbundled loop, transport and switching. Adopting these elements as minimum guidelines would be a reasonable first step. However, going beyond establishing guidelines based on these elements or specifying additional unbundled elements at this early stage of the "discovery process" inherent in implementing local competition would be unwise and contrary to Congressional intent. Individual negotiations are likely to do far better than any FCC mandate in determining which unbundled elements should be offered in particular locations and whether any additional unbundled elements should be made available. Under negotiated agreements, the incremental costs of unbundling will be incurred only where there is actual demand for the unbundled elements.

Experience with ONA is pertinent in this regard. In the ONA proceeding, enhanced-service providers (ESPs) came forward with long lists of unbundled elements that they desired. They hoped, however, that they would not have to pay the costs of unbundling. The FCC did not mandate particular ONA capabilities but did exert strong pressure on LECs to provide unbundled capabilities. LECs responded by offering a broad range of basic-service elements (BSEs). In doing so, they incurred substantial costs. Unfortunately, subsequent sales of BSEs did not justify much of the

unbundling cost. In particular, BellSouth currently provides 133 interstate BSE rate elements. There is no (interstate) demand whatever for 118 of these.

In retrospect, the FCC should have relied more on actual demand and exerted less pressure on LECs to unbundle, as a general principle. That conclusion is far more obvious now than it was at the time. In any event, the FCC should not repeat the same mistake in this proceeding. The FCC rightly wants to avoid letting incumbents give entrants the long, slow roll in processing unbundling requests. However, by keeping the focus on localized, *bona fide* demands for unbundling, regulators can prevent a recurrence of the waste associated with ONA.

D. Facilities Pricing

Arbitrage possibilities must be considered in pricing facilities that can be used for multiple services. Consider a simple example:

- Suppose that a dedicated facility connects a CLEC to an end user. Suppose that the facility is priced less than interstate special access. Then, if the CLEC is also an IXC (which is far from unlikely), it has the incentive to use the facility for interstate, as well as local calls. Conversely, if the facility is priced higher than special access, CLECs who are also IXCs have the incentive to purchase special access and use it for local, as well as interstate calls.

As a result of such arbitrage, there can, in practice, be only a single price for facilities between carriers and end users. There cannot be separate prices for interstate special access and unbundled local loops. Analogous to Gresham's Law, the cheap service will drive out the dear service.

Regulatory rules are unlikely to work well in stopping such arbitrage. In the first place, there is no effective way to enforce the rules. Also, rules mandating unmixed usage (if obeyed) reduce efficiency, according to the laws of traffic engineering. The FCC could conceivably ask carriers to report the relative usage of dedicated facilities; *i.e.,* how much was local and how much, interstate. Unfortunately, carriers do not generally measure the usage of dedicated facilities.

For these reasons, there should be no requirement that facilities be priced below interstate levels. The inevitable consequence would be to collapse the interstate rate structure. Pricing facilities

above interstate rates would probably do no harm. In that case, customers could be expected to obtain facilities primarily at interstate rates; the higher facilities rates would be of little consequence.

IV. Resale

The Act imposes resale obligations on LECs. All LECs, whether incumbents or entrants, are required to allow resale of their services and not to impose unreasonable or discriminatory conditions or limitations on the resale of their services.[22] In addition, incumbent LECs are required to establish wholesale rates for any services provided to subscribers who are not telecommunications carriers. Incumbents are also prohibited from imposing unreasonable or discriminatory conditions or limitations on the resale of telecommunications service. State commissions are permitted to impose a prohibition on a reseller offering service obtained at wholesale rates to a different class of subscribers than such service is available to at retail.[23] State commissions are directed to determine wholesale rates on the basis of retail rates, "excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the LEC."[24]

Resale can play an important role in lowering barriers to entry and making competitive alternatives more available to consumers. As we noted earlier, regulators must steer a careful course between Scylla and Charybdis. In this instance, as before, Scylla involves providing inadequate scope for competition. Facilitating the resale of LEC services will lower barriers to entry. However, excessive wholesale discounts would discourage the deployment of facilities-based competitive alternatives. Charybdis then appears on the horizon. Clearly resale allows competitors to enter local telecommunications markets without incurring the cost of installing facilities. A competitor could build a customer base and then later arrange to construct its own facilities or use other competitive facilities to serve them. Cash flow could be more favorable and risk could be reduced by using a resale strategy to enter the markets for local telecommunications services. The operative word here is "could." The Charybdis that regulators must avoid is undermining incentives to construct a facilities-based competitive alternative through overly-generous discounts for wholesale service.

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22 47 USC 251(b)(1).

23 47 USC 251(c)(4). LECs should be permitted to restrict the resale of its residential service to business customers given the way many state commissions now require both services to be priced. The new federal act expressly permits the state commissions to allow such a restriction [251(C)(4)(B)] and the FCC should not interfere with those prerogatives.

24 47 USC 252(d)(3).

If the resale policy is so tilted that any entrant finds it difficult to choose "make" when assessing the "make or buy" decision, then the policy is not leading to the type of competition (facilities-based) that the Congress envisioned when passing the Act. The new Act is clear about using the standard of avoided costs for establishing wholesale rates. The standard is not, nor should it be, to ensure the success of any particular reseller's business plan for selling local exchange service. If a reseller is more efficient than the incumbent LEC at undertaking marketing, billing, collection and other activities, then it can have a successful venture. However, even if it is not more efficient, it may still be motivated to capture market share using resale so as to move those subscribers later to a facilities-based competitive alternative.

A. Avoided Costs

A reseller undertakes marketing, billing, collection and customer service to its own retail customers. If the facilities-based carrier no longer provides these functions to the reseller's customers, it would disadvantage a reseller to pay for these costs twice: once by incurring them itself and another by paying rates that included the facilities-based carrier's costs of performing these same retail functions. The Act therefore provides that a state commission shall determine wholesale rates by basing them on retail rates and then excluding the avoided costs.[25]

However, while a facilities-based carrier may be able to avoid certain marketing, customer service, and billing costs by selling to a reseller instead of to a retail customer, it will, in general, need to incur additional costs to establish and maintain interfaces with the reseller. For example, when a customer calls a reseller to report a service problem, the reseller will need to communicate with the facilities-based carrier and solve the problem. While the facilities-based carrier no longer fields the inquiry directly from the retail customer, it now needs to field an inquiry from the reseller. The Act does not preclude the FCC or state commissions from taking these added costs into account. Indeed, they *should* take such costs into account.

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[25] 47 USC 252(d)(3).

B. Resale as a Competitive Safeguard

In the Notice, the FCC cited its earlier uses of resale as a competitive safeguard in long-distance and other markets.[26] It has had a long-standing policy of permitting resale of high-volume, low-price offerings as a check on a carrier's ability to engage in anticompetitive pricing behavior. Until now, regulators have not focused on wholesale rates for resold service. Instead, their focus has been on permitting the resale of volume discounts offered to large users. This distinction is important distinction, since the amount of the discount, and therefore the retail margin, is set by the carrier, and not by the regulator.

Local exchange markets pose a different set of circumstances. By definition, LECs have not offered high-volume residential services. (If a residential customer orders a large number of lines, the presumption has been that the customer operates a business and that business rates should therefore apply instead of residential rates.) In contrast to long-distance markets, there are no high-volume residential pricing plans for a reseller to take advantage of. High-volume business services generally are available, though. Resale can (and does, in many cases) take place for high-volume business services, such as DS-3. Such resale occurs without regulators establishing an explicit wholesale discount. The reseller finds customers by pricing its services somewhere in the margin between the retail price of low-volume business service and the high-volume business service it is reselling.

C. Estimating Avoided Costs

The new Act requires that a wholesale rate be determined by using the tariffed retail rate as a base, less avoided cost. Some analysts of avoided costs take an extremely simplistic approach and overestimate the marketing, billing, collection and other costs than can be avoided. For example, a study performed by Economics and Technology, Inc. argues that entire broad cost categories would

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[26] Notice, fn. 235 at para. 176.

be avoided.[27] In reality, a LEC will still need to bill the reseller and will incur costs to do so. Similarly, it will need to have a customer service interface with the reseller and will need to incur costs to do so. These operations may be done at a different cost level for a reseller as opposed to a retail customer, but the idea of eliminating entire broad categories of operations is erroneous.

Some, but not all, marketing costs can be avoided with resale. Resellers argue that they require closely coordinated interfaces with the company whose services they resell so as to offer a comparable level of service. They observe that a potential subscriber who calls an incumbent LEC can get service installation scheduled and a telephone number issued while on the telephone call with the service representative. They then argue that a potential subscriber calling a reseller should be able to receive the same level of service. Achieving that outcome requires mechanized interfaces with the incumbent's systems for determining facilities availability and scheduling installation appointments. These interfaces are an example of marketing costs that are not avoided with resale. They represent additional costs that are not incurred when the incumbent sells directly to its own customer on a retail basis. Where LECs incur additional costs with resale, they should be permitted to impose an additional charge on resold service to recover these costs.

D. Promotional Pricing and Trials

The FCC's resale rules should not preclude offering promotional pricing or trials on a limited basis. Promotional prices and trials are already in use and are important tools to introduce new services. For example, many Internet information and software providers offer their wares cheaply, or even free of charge, in order to get consumers to try them and perceive the value they would obtain from making a purchase. LECs should be able to market the same way. Many state commissions permit promotions or trials on a limited basis. However, if regulators required LECs to permit widespread resale of such promotions and trials, LECs would likely be deterred from introducing new and innovative services, an undesirable outcome from the standpoint of consumer welfare. Consequently, the FCC's rules should permit LECs to offer promotional pricing or trials on a limited basis. State regulators would prevent the LECs from abusing the restrictions by extending a

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[27] Economics and Technology, Inc. *Commercially Feasible Resale of Local Telecommunications Services: An Essential Step in the Transition to Effective Local Competition* (Boston: Economics and Technology, Inc., July 1995).

promotion to all their customers on an extended basis. These freedoms have long been available in the state jurisdictions and things have been working satisfactorily. It would be counterproductive to restrict the ability of LECs to address customers' needs in the name of permitting resale.

One final note on the topic of resale: this issue is being debated and resolved in proceedings taking place in state jurisdictions. LECs and competitors in some cases have reached agreements on having a wholesale discount when reselling the LEC's services.[28] The FCC's rules should allow for resale arrangements using negotiated wholesale discounts.

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[28] *See, e.g.*, "State Activities," *Common Carrier Week* (Nov. 6, 1995) (". . . Ameritech also announced agreement under which 2-year-old company U.S. Network will resell Ameritech service to Chicago area businesses. . . . Discounts will average 6% for residential service and 10% for business, RHC said."); "Competition Update: AT&T Gets Authority to Provide Local Service in Chicago; Eyes Md., Conn., Wisc. Markets," *Telco Competition Report* (Jan. 18, 1996) ("Ameritech had filed [in Illinois] proposed local exchange service resale tariffs following agreements with U.S. Network Corp. and MFS Communications Co., Inc. to resell its service.").

V. Conclusions

To achieve the public-interest objectives of the Act, interconnection policy should be designed to achieve effective economic integration, as well as efficient technical interconnection. To achieve economic integration, regulators must steer a middle course between Scylla (inadequate scope for competition) and Charybdis (regulatory giveaways to new entrants that distort competition and promote resource waste).

As a result of long-standing regulatory policies, the current rate structure in telecommunications is highly distorted and departs substantially from an economically efficient rate structure. It is (long past) time for policymakers to rationalize government regulations to permit efficient competition and to promote economic efficiency. Until such restructuring occurs, any interconnection policy is sure to afford opportunities for arbitrage and incentives for inefficient behavior. The best way to cope with these problems is to allow carriers broad scope to negotiate interconnection agreements, subject to oversight by state commissions and ultimately the FCC. Specific FCC rules cannot be adequately tailored to the vast variety of local circumstances. For that reason, such rules will often be inappropriate and may do more harm than good. Instead, the Commission would be better advised to enumerate basic objectives and identify broad policy guidelines to afford a roadmap to help inform negotiations among private parties and standards for constructive oversight by state commissions.

Prices of unbundled elements properly include the incremental cost of unbundling (over and above the cost of the bundle itself). They should also include a markup in addition to incremental cost of the element and in addition to the incremental cost of unbundling itself. The markup would cover relevant overheads, contribution to common costs, and any burdens growing out of government-imposed obligations and government decisions.

Under the current rate structure, large users of toll and access services pay contribution to support services consumed by other people. Regulators should allow carriers to phase out such support payments as rapidly as is feasible. Until prices are restructured, interconnection policies should not allow end users to avoid paying their fair share of any burdens by (indirectly) purchasing unbundled elements which lack adequate provision for contribution. The FCC should not mandate in great detail which unbundled elements should specifically be provided. Instead, unbundled

elements should generally specifically be provided only in response to *bona fide* demands. Mandating the provision of unbundled elements could lead to a recurrence of the economic waste associated with ONA.

The Act mandates resale at tariffed rates less avoided cost. In implementing this provision, regulators need to take account of not only avoided costs, but also the additional costs that LECs may incur as a result of resale. Those costs will need to be recovered in wholesale rates or in additional charges imposed on resellers.

We believe that the FCC has a key role to play in facilitating efficient local competition. In particular, it should facilitate restructuring of LEC rates to improve economic efficiency. Such restructuring will reduce possibilities for arbitrage and incentives for inefficiency. It will thereby contribute to economic integration. As the Commission has recognized in its Notice, this important task necessitates coordinated action on a number of related fronts. Some of these involve other important Commission proceedings (*viz.*, Access Restructuring, Universal Service, Price Caps), but Commission action on these and related matters must also be coordinated with various state initiatives. The tasks are of truly monumental proportions, but failure to coordinate disparate actions on manifold fronts will necessarily compromise successful achievement of the Act's objectives.

We do not think that the FCC should try to closely circumscribe activities that the Act delegates to state commissions and, in the first instance, to private parties. Doing so would deny state commissions the flexibility they need to cope with the complexity they face. It also diverts Commission resources away from the most important task the Commission confronts: getting prices right. Now is the time for regulation to confront the fundamental issue competition poses. It will ultimately prove both fruitless and impossible to will the competitive means, but refuse to accept the consequences of competition. The current pricing structure cannot coexist with competition. Failure to act now to correct current mispricing will produce great economic waste and undermine achievement of the Act's visionary promise.